

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: DEREGULATION OF LOCAL EXCHANGE SERVICES IN COMPETITIVE MARKETS	DOCKET NO. INU-04-1
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ORDER INITIATING NOTICE AND COMMENT PROCEEDING

(Issued May 7, 2004)

It is the policy of the state of Iowa that communications services should be available throughout the state, from a variety of providers, at just and reasonable rates. Iowa Code § 476.95(1). This policy was formally adopted by the state of Iowa in 1995. At the same time, Iowa's rate-regulated carriers were permitted to enter a price cap form of regulation designed to assist carriers on the path to competition and, eventually, deregulation. Even before the state enacted this policy, the Utilities Board (Board) acted to further telecommunications competition in Iowa by deregulating a number of telecommunications services.¹

¹ See "Order Adopting Rules," In Re: Rules Regarding Treatment of Costs Associated with Inside Wiring, etc., Docket No. RMU-81-19, issued October 8, 1982; "Order Adopting Rules," In Re: Deregulation of the Terminal Equipment Market, Docket No. RMU-82-1, issued February 9, 1983; "Order Adopting Rules," In Re: Terminal Equipment—Amendments to Chapters 22 and 16, Docket No. RMU-85-6, issued July 26, 1985 (deregulating pay telephones); "Order," In Re: Northwestern Bell Telephone Co., Docket No. RPU-84-8, issued September 5, 1984 (deregulating Centrex services and certain private line services); In Re: Investigation Into the Competitiveness of Versanet Service, Docket No. INU-85-5; In Re: Mobile Telephone Service and Paging Service, Docket No. INU-86-2; In Re: Intrastate Billing and Collection Service Tariffs, Docket No. INU-88-10; In Re: Deregulation of InterLATA Interexchange Message Telecommunications Services, etc., Docket No. INU-88-2; In Re: Deregulation of Touch Calling and Custom Calling Features, Docket No. INU-88-8;

Nationally, the local telecommunications market was opened to competition in the year following the enactment of Iowa's statute with the federal Telecommunications Act of 1996 (the Act). The Act allowed competitive local exchange carriers (CLECs) to resell the retail services of the incumbent local exchange carriers (ILECs), to use the ILEC's facilities (in whole or on a piece-by-piece basis²), or to build their own facilities. In addition, the Act mandated that each telecommunications carrier has the duty to interconnect with other carriers.³ Further, each ILEC has the duty to negotiate agreements regarding resale of its telecommunications services, number portability, the provision of dialing parity, access to its poles, ducts, conduits, and rights-of-way, and the establishment of reciprocal compensation arrangements for the transport and termination of telecommunications.⁴ Many CLECs in Iowa rely upon the ILEC's wholesale services to provide some or all of their own retail services. In other words, these CLECs "rent" the ILEC's facilities at a wholesale rate and use those rented facilities to offer service to customers. This relationship appears to form the basis for much of the local exchange telecommunications competition in Iowa.

In Re: Deregulation of Recording Function of Billing and Collection Services, Docket No. INU-88-9; and, In Re: Deregulation of Competitive IntraLATA Interexchange Services, etc., Docket No. INU-95-3; In Re: U S West Communications, Inc., n/k/a Qwest Corporation, Docket No. INU-00-3.

² A CLEC could lease separate unbundled network elements (UNEs) or the entire UNE-platform (UNE-P) from the ILEC.

³ 47 U.S.C. § 251(a)(1).

⁴ 47 U.S.C. §§ 251(b) and (c).

On August 4, 2003, the Board began a statewide telecommunications competition survey to evaluate the state's progress toward the widespread availability of local exchange services from multiple providers at reasonable rates. The survey was prompted in part by the number of local exchange providers in Iowa that have received certificates to provide service. The Board was interested in whether these competitors were actually providing service, what services were being provided, and the extent to which customers were switching providers. The survey indicates that the raw number of providers doing business in parts of the state does not automatically mean that customers in any particular location have a real choice of local exchange providers or services.

The survey data also shows that customers in certain specific geographic areas or certain customer groups do, in fact, have some choice of providers. With this apparent increase in telecommunications competition, the Board believes it is appropriate to examine these markets more closely with the intent of considering action. This may include deregulation or implementation of some form of flexible regulation. (The Board is required by statute to be open in its approach to regulation and to respond to changes in the industry with speed and flexibility. Iowa Code § 476.95(4) and (5).)

Therefore, the Board will initiate this proceeding on its own motion, pursuant to Iowa Code § 476.1D (2003) and 199 IAC 5.3(1) (2003), and identified as Docket No. INU-04-1, to consider whether local exchange service to business and residential

customers in certain Iowa communities is subject to effective competition and should be deregulated. The Board will also consider in this proceeding whether residential second line service throughout Iowa is subject to effective competition and should be deregulated.

The Board recognizes that the telecommunications industry in Iowa is always changing and that the question of deregulation should be considered from time to time. The Board intends to approach the possible deregulation of local exchange service in Iowa in multiple stages. The first phase is initiated by this docket and relies on the specific data in the Board's survey report and on the available information regarding the market for second lines in residential use. The Board believes that the survey report has provided sufficient data to make some preliminary proposals of deregulation at this time.

The Board intends to follow this proceeding with a second phase in which the Board will consider other areas of competition provided by CLECs. This second phase may involve, among other things, the level of competition provided by CLECs using UNE-P (if it continues to be a viable alternative), the impact of emerging technologies, and provider of last resort (POLR) responsibilities. The Board may also initiate a rule making proceeding to consider a revised deregulation process that might be better suited to current conditions. Finally, as a part of the ongoing process of deregulation, the Board is especially interested in investigating options that may

provide the Board with the flexibility to ease regulatory burdens without total deregulation in order to better respond to industry changes.

THE BOARD'S AUTHORITY TO DEREGULATE COMMUNICATIONS SERVICES

Iowa Code § 476.1D requires that the Board deregulate a communications service or facility if the Board determines that the service or facility is subject to effective competition. In making that determination, the Board must consider, among other factors, (1) whether a comparable service or facility is available from a supplier other than the telephone utility and (2) whether the resulting market forces are sufficient to assure just and reasonable rates without regulation. Iowa Code § 476.1D(1).

The Board has promulgated rules to aid in determining whether a service or facility is subject to effective competition. Subrule 199 IAC 5.6(1) provides that the Board may consider the following criteria when making this determination:

- a. The ability or inability of a single provider to determine or control prices;
- b. The ease with which other providers may enter the market;
- c. The likelihood that other providers will enter the market;
- d. The substitutability of one service or facility for another; and,
- e. Other relevant considerations.

199 IAC 5.6(1). The rules also specify additional criteria the Board may consider in determining whether a service or facility should continue to be subject to service

quality regulation, notwithstanding the existence of effective competition. See 199 IAC 5.6(2).

The Board has adopted these rules to assist in determining where effective competition exists. The factors described in these rules are consistent with well-established economic theories regarding competitive markets that are widely used, in one form or another, by nearly all states. The determination of effective competition in a market, compared to the simple presence of multiple providers, is significant to an analysis for deregulation since competition must be sufficient to prevent anti-competitive behavior upon deregulation. The mere presence of other providers in the market, without more, is not enough to say that a market is effectively competitive. Rather, a finding of effective competition means that the current level of competition is sufficient to discipline prices and ensure reasonable service quality.

In the absence of effective competition, unregulated monopolies would be able to raise prices to unreasonable levels with an undesirable effect on the public. Moreover, without effective competition an unregulated provider with some monopoly services could engage in predatory pricing; that is, it could reduce prices in markets where it faces limited competition and support the losses with monopoly profits from other exchanges. The result would be to drive any potential competitors out of the market and deter others from entering. Therefore, the determination of effective competition is required before a service or facility can be deregulated and regulatory constraints lifted in their entirety.

In considering whether a communications service is subject to effective competition and can be deregulated, the Board has recognized there is no single factor or criterion that is determinative. Instead, the Board has considered and balanced a number of factors, as described in previous orders regarding deregulation. (See the orders cited in footnote 1.) In addition, the Board has reviewed the standards applied by other states that have conducted formal competition analyses for intrastate telecommunications markets. Based on a report published by the National Regulatory Research Institute (NRRI) in October 2003,⁵ at least 33 states have completed some form of competition analysis using, among other factors, the following indicators for effective competition: market share, the number of CLECs providing service, the quality of service provided, the number of interconnection agreements, wholesale or UNE rates, the number of CLEC switches or collocation points, customer satisfaction measurements, and retail price comparisons for basic services.⁶ Any of these factors can be relevant in determining whether a particular communications service or facility is subject to effective competition and can be deregulated.

In addition to the statutory factors, the criteria listed in the Board's rules, and the factors considered by other states, in this docket the Board will examine whether the existence of wireline facilities-based competitors (as defined below) in a particular

⁵ "State Analysis of Competition in the Telecommunications Markets: Results of an NRRI Survey," NRRI Report, October, 2003. The NRRI survey may be viewed at www.nrri.org.

⁶ *Id.*

geographic market should be a separate factor for review. Facilities-based competition is likely to be critical for competition to grow and flourish in the local exchange market. Without it, competitors must depend upon the incumbent's system in order to provide their own competitive services. As a result, the CLECs are at least somewhat constrained in their ability to offer new and different services. While UNEs and resale service make it easier for CLECs to enter any particular market, over-reliance on resale and UNE-P can limit a CLEC's ability to provide products and services that differ in price or features from those offered by the incumbent. This situation creates a dependency on the incumbent's system by the competitor and reduces the range of options available to customers. Therefore, consideration of the existence and number of facilities-based competitors in a community is likely to be an important consideration in this proceeding.

Facilities-based competition, rather than UNE-P, will be the focus of this proceeding as, currently, there is regulatory uncertainty at the federal level regarding the future of UNE-P. In August 2003, the Federal Communications Commission (FCC) issued its Triennial Review Order (TRO),⁷ wherein the FCC found that if an ILEC can show three or more CLECs are using their own facilities, in whole or in part, to compete with the incumbent, then the incumbent should no longer be required to

⁷ *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, and 98-147, "Report and Order on Remand and Further Notice of Proposed Rulemaking." (Rel. August 21, 2003).

offer UNE-P to its competitors in that market. A three-judge panel of the D.C. Circuit Court of Appeals, upon review of this portion of the TRO, found that the FCC erred in maintaining competitors' mass-market access to unbundled switching and inter-office transport.⁸ As a result, UNE-P discounts may no longer apply to CLECs. If this ruling is not altered by further review, then UNE-P will no longer be an available option to competitors of incumbents. Because of this regulatory uncertainty, the Board will not consider UNE-P based competition, by itself, as a basis for deregulation in this proceeding until more is known about the future status of UNE-P. A consideration of competitors that use UNE-P may be addressed in the next phase of the Board's ongoing deregulation process. At that time, there should be better information available as to whether the competition currently provided through UNE-P is sustainable.

THE LOCAL COMPETITION SURVEY

On August 4, 2003, the Board initiated a comprehensive industry-wide survey to obtain an overview of the status of local exchange telecommunications competition in Iowa. The survey was sent to approximately 280 companies that currently provide, or have the potential to provide, local telephone service in Iowa. A total of 239 telephone service providers, including 93 percent of the wireline carriers, responded to the survey. The survey results are described in a report issued January 26, 2004, and available on the Board's Web site at www.state.ia.us/iub.

⁸ *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004).

As previously mentioned, to make a finding of effective competition the Board must determine if (1) there are multiple providers of a service or facility and (2) existing market forces are sufficient to ensure just and reasonable rates without regulation. Iowa Code § 476.95(1). The survey report helps to identify the communities with multiple providers. Whether existing market forces are sufficient to determine just and reasonable rates is the focus of this proceeding.

The survey data shows that despite the large number of local exchange service providers in Iowa,⁹ competitive local exchange service is not universally available. While some customers in Iowa's urban exchanges have multiple choices for their local exchange service provider, there is little or no competitive choice in most rural exchanges (although there are exceptions). Further, while competition for local exchange service appears to be increasing, the incumbent providers continue to serve the majority of the customers in the state.

Specifically, the survey data shows that statewide the incumbents serve 92 percent of the residential customers and 77 percent of the business customers. Qwest Corporation (Qwest), the largest incumbent carrier in the state, continues to serve almost 90 percent of the residential lines and over 70 percent of the business lines in its service territory, although its market share in any particular exchange may be higher or lower. Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom

⁹ Many of these telecommunications service providers are ILECs that generally do not compete against each other; instead, they concentrate their efforts on their own separate service territories.

(Iowa Telecom), the second largest incumbent, serves about 93 percent of the residential lines and 81 percent of the business lines in its overall service territory. Frontier Communications of the Midwest, Inc. (Frontier), has some competition in 4 of the 49 communities it serves, but the competitors serve only a few business customers. The survey data shows that Frontier serves 100 percent of the residential lines and 99 percent of the business lines in its service territory.

These survey results demonstrate that the incumbent companies retain a significant market share when measured on a state wide basis. However, the survey also shows that competitive telecommunications providers that cater to certain customer classes appear to be making strides in some exchanges. Similarly, in some of the exchanges certain CLECs have successfully constructed their own wireline networks. These "overbuilt" markets may represent a different situation altogether, as discussed below. Therefore, the inquiry into competitive status must be looked at more narrowly rather than on a state wide basis.

The Board intends to rely on the survey report throughout this proceeding. As such, the Board invites comment on the use of the survey report as well as the survey's content. Moreover, the Board will direct providers in certain exchanges to file updated survey responses for those exchanges. This will provide more current data for the Board's consideration and a benchmark for evaluating the data from the initial survey.

THE STATUS OF COMPETITION IN THE LARGER IOWA COMMUNITIES

Based on the survey's data, it appears that some customers in certain larger urban communities have comparable local service available from a supplier, or multiple suppliers, other than the incumbent telephone utility. The resulting market forces in these larger communities may be sufficient to assure just and reasonable rates without regulation and may demonstrate the presence of effective competition.

For purposes of this proceeding, the Board is distinguishing these larger communities from smaller, overbuilt communities (discussed below) by defining these larger markets as being Ames, Cedar Rapids, Council Bluffs, Davenport, Des Moines, Dubuque, Iowa City, Sioux City, and Waterloo.

In two of these markets, it appears the incumbent provider faces significant competition from at least one CLEC that uses its own network to offer basic local exchange service to a substantial portion of the market. In Council Bluffs,¹⁰ for example, two of the competitors together serve between 25 percent and 30 percent of the residential market and between 20 percent and 25 percent of the business market. One of the two competitors, Cox Communications, Inc. (Cox), serves a significant part of the market using its own cable network, while another competitor, McLeodUSA Telecommunications Services, Inc. (McLeod), uses UNE-P and resale. Cox's service offerings include basic residential local exchange service for \$12.95 per month, which is comparable to Qwest's basic residential rate of \$12.65 per

¹⁰ For purposes of this proceeding, the Council Bluffs market also includes the following communities: Loveland and Wilson.

month. In addition, 13 other CLECs also provide service to the Council Bluffs market. However, their individual market shares are much smaller and many of these CLECs appear to have targeted specific niche markets; Houlton Enterprises, d/b/a Guaranteed Phone Service (Houlton), is a prepaid service that serves only residential customers, while AT&T Communications of the Midwest, Inc. (AT&T) and TCG Omaha (TCG) both cater to the business market through use of UNE-P.

In the Sioux City market,¹¹ the survey data shows the top two competitors serve between 10 percent and 15 percent of the residential market and between 45 percent and 50 percent of the business market. FiberComm, L.C. (Fibercomm) has built its own network in the downtown area of Sioux City, whereas McLeod uses UNE-P and resale. FiberComm offers service to its business customers at a rate of \$21.25, which is comparable to Qwest's business pricing of \$25.60 to \$28.35. There are four other competitors in the Sioux City business market that together account for less than five percent of the market share.

The existence of substantial CLEC networks in the Council Bluffs and Sioux City markets distinguishes them from the other large exchange markets. For example, the Cedar Rapids market lacks a large network-based competitor. The survey data shows the top two competitors in Cedar Rapids serve between 10 percent and 15 percent of the residential market and between 30 percent and 35 percent of the business market. McLeod owns a switch in Cedar Rapids but has a

¹¹ For purposes of this proceeding, the Sioux City market also includes the following communities: James and Westfield.

relatively limited amount of local loop facilities. The majority of McLeod's service appears to be provided using UNE-P or UNE-loop.¹² Moreover, McLeod does not provide a residential or business basic service offering that is comparable in price to Qwest's basic service offerings.

Based on the differing competitive situations of the nine large community markets as shown by the information collected from the survey (as detailed above), in this proceeding the Board proposes to consider deregulation of residential and business local exchange telecommunications services in the Council Bluffs market and business services in the Sioux City market. The Board intends to consider such factors as market share data, the presence or absence of wireline facilities-based competitors,¹³ the presence or absence of competitors offering basic local exchange service at rates comparable to the ILEC's rates, and the presence or absence of competitors using UNE-P or resale to compete for customers. The Board specifically invites comment on each of these factors and on other factors that may be appropriate for its consideration.

At this time, the Board does not propose deregulation of any service in the remaining seven large community markets. These other markets do not currently include a large, wireline facilities-based competitor. Moreover, these markets do not

¹² A UNE-loop involves each of the various services and facilities that goes into providing local telephone service including the wire loop that serves the customer and switching services.

¹³ In this proceeding, the Board is defining "wireline facilities-based competitors" as CLECs that have their own wired network, separate from the ILEC's network, that are capable of offering and providing service to a significant part of the defined market.

appear to include a CLEC that is currently offering basic unbundled local exchange services to business or residential customers at prices that are comparable to the ILEC's rates for basic service. While some CLECs have gained market share in each of these markets, they have done so primarily on the basis of UNE-P and resale and many are serving niche markets rather than offering an alternative to basic service.

As previously discussed, UNE-P is currently subject to a high degree of regulatory uncertainty. In this initial proceeding, the Board does not propose to consider deregulation of any markets where UNE-P and resale are the significant sources of competition. Additionally, the Board recognizes that many CLECs use UNE-P and resale to offer bundled service packages that include basic voice service as one component. Bundled service offerings may include such deregulated services as long distance calling, call waiting, caller identification, call forwarding, and three-way calling. The Board does not propose to separately consider deregulation of these bundled service offerings in this proceeding. Rather, the Board intends to consider the possible deregulation of all of the local services in the identified markets including plain old telephone service.

OVERBUILT EXCHANGES

In several smaller communities, CLECs have overbuilt all or nearly all of the existing incumbent's local wireline facilities. Overbuilding involves the placement of physical network facilities by the CLEC that allow it to furnish local exchange services to the customer independent of the incumbent's operations. Overbuilds have been

completed by cable companies, CLECs, and municipal telecommunications utilities. The majority of facility overbuilds, however, involve the construction of network facilities only within the urban areas of these communities. For the most part, the rural areas surrounding the overbuilt communities continue to have voice services provisioned only through the use of the incumbent's facilities.

The CLECs in these overbuilt communities are offering local service in competition with the incumbent service providers and, in some instances, have acquired a market share greater than 50 percent for both residential and business customers. In several of these communities, this circumstance has resulted in a division of the market between two dominant carriers even if other CLECs are present.

Basic economic theory would indicate that these duopoly situations are not likely to be examples of effective competition. However, as described below, it appears the situation in these exchanges differs in significant ways from a textbook market. For example, if these markets are deregulated the Board will still be able to monitor the competitors and, if necessary, re-regulate. Readily available re-regulation is not a feature of many markets. Therefore, based on the availability of competing local exchange service to most customers from two providers with separate networks, each with a substantial market share, the Board proposes to deregulate all local telecommunications service in the following communities: Laurens, Mapleton, Spencer, Storm Lake, Whiting, Armstrong, Belle Plaine, Conrad,

Coon Rapids, Delmar, Forest City, Harlan, Lowden, Oxford, Oxford Junction, Primghar, Saint Ansgar, Solon, Stacyville, Stanwood, Steamboat Rock, and Tiffin. Incumbent exchange service in two of these communities, Conrad and Steamboat Rock, is in the process of being transferred. The Board invites comments on whether this fact has any bearing on the proposed deregulation of these exchanges.

In some of these exchanges only the urban areas have been overbuilt. Rural customers continue to receive local service only through the use of the incumbents' facilities. The Board specifically requests comments regarding this situation, including the question of whether all service providers can and should be required to provide local service to the rural customers at rates comparable to the urban area after deregulation.

DUOPOLY CONCERNS

In prior orders (discussed below), the Board has expressed its concern that in markets where only two competitors effectively share the market, deregulation could lead to duopoly price behavior entailing price collusion or price predation followed by monopoly pricing. Either situation would likely result in a decrease in competition rather than an increase.

The Board has expressed its concerns regarding duopolies in at least two previous deregulation dockets. In both cases, the Board declined to deregulate based, at least in part, on these concerns. See In Re: U S West Communications, Inc., "Order Denying Petition to Deregulate," Docket No. INU-99-3, March 1, 2000

(the U S West docket); In Re: Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom, "Order Denying Petition for Deregulation," Docket No. INU-01-1, April 5, 2002 (the Iowa Telecom docket). Nevertheless, the Board believes the time is right to revisit the duopoly issue. There are significant differences between the competitive environments in the markets proposed for deregulation in this docket and the markets previously considered by the Board. Further, the Board proposes to establish a market-monitoring mechanism pursuant to Iowa Code § 476.1D(6) through (9) for all deregulated local exchange markets that will allow it to take corrective action if the competitive market fails to grow and develop beyond two providers.

The U S West and Iowa Telecom dockets appear to be distinguishable from the present situation. The U S West docket involved an ILEC from an adjoining exchange (South Slope Cooperative Telephone Company, Inc., hereinafter South Slope) that constructed new facilities to serve relatively small parts of the U S West exchanges in Coralville and Cedar Rapids, Iowa. U S West requested deregulation of its local exchange services throughout these communities, arguing that the presence of South Slope in small parts of each exchange amounted to effective competition in the entirety of the exchanges. The Board denied U S West's request, finding that it was impractical to deregulate only the small parts of these exchanges where South Slope was competing with U S West. It also held that limited competition in a small part of an exchange was insufficient to justify deregulation of

the entire exchange. As there was no evidence that South Slope intended to expand its facilities to serve other parts of the exchanges at issue, there was no basis for deregulation of the entire exchanges.

In this proceeding, the Board is considering deregulation of certain services throughout all of the Council Bluffs and Sioux City regions, two markets that include multiple exchanges. This is in contrast to the small portions of specific exchanges that were at issue in the U S West docket. Further, the existing wireline facilities-based competition in Council Bluffs and Sioux City appears to have a greater affect on each market than was the case in U S West. Based on the survey results, it is clear there are many competitors throughout these two markets, indicating that competition in these urban areas is more robust than was the case in the U S West docket. For all of these reasons, the situation in this proceeding appears to be quite different from the U S West docket.

The Iowa Telecom case involved a petition to deregulate nine exchanges where Iowa Telecom was experiencing competition. The record in that proceeding demonstrated that in each of the nine exchanges there was only one local service competitor with no reasonable prospect of additional entry. The Board denied Iowa Telecom's petition, concluding that having only two telephone companies in each of the exchanges created a duopoly that would not provide effective competition or assure reasonable rates without regulation.

Here, the Board is proposing deregulation of many of the same exchanges based on similar facts. However, as described below, the Board is also considering establishment of a market-monitoring mechanism that should alleviate any potential duopoly concerns. The Iowa Telecom docket did not address a similar market monitoring mechanism.

The Board's concern about deregulation of duopoly markets is largely based on economic theories that suggest three, four, or even five providers may not be enough to justify a finding of effective competition. The typical market power measures include the Herfindahl-Hirschmann Index (HHI) and the Landes-Posner Index (LPI). These competition measures, which rely heavily on a structural analysis of the market, are useful in merger and antitrust analyses. In this proceeding, however, the Board questions whether these metrics are useful in determining the dynamics of local exchange service competition for purposes of deregulation. Rather, it appears that in this setting the best use of the measures utilized by HHI and LPI may be to track changes in market shares over time for the Board's consideration, along with other evidence such as the number of competitors, level of advertising, pricing, ease of entry, line loss data, and customer loss data.

Moreover, the HHI and LPI were developed for use in a different context, that of merger and antitrust analysis in markets that typically lack a regulatory presence like the Board. As such, it appears these particular tests were designed to ensure the existence of a competitive marketplace where there is no ready regulatory

alternative. In this docket, however, the Board will remain as a potential regulatory presence even after a service or facility is deregulated. Specifically, Iowa Code § 476.1D(6) gives the Board express authority to reimpose rate and service regulation on a deregulated service or facility if the Board determines the service or facility is no longer subject to effective competition. Iowa Code § 476.1D(7) allows the Board to reimpose service regulation, even in the presence of effective competition, if the service or facility is an essential one and the public interest warrants service regulation. Finally, Iowa Code § 476.1D(9) authorizes the Board to investigate and obtain information from providers of deregulated services or facilities so that the Board can decide whether it needs to reimpose rate or service regulation. Taken together, these statutory provisions appear to allow the Board the flexibility to deregulate markets that are subject to effective competition while providing a safety net of re-regulation where necessary to protect the public interest.

The determination of effective competition in a market is not usually a one-time decision that can be made on the basis of a simple test. Instead, it may be appropriate to consider deregulation as a continuing process of evaluating a number of factors, and the list of relevant factors may change in response to changing conditions. For this reason, it is appropriate that the Board re-evaluate its duopoly concerns in this proceeding. For the same reason, however, the Board intends to consider implementing an ongoing means of market monitoring to ensure that effective competition continues after deregulation. It will also evaluate the conduct

and performance of competing companies in any deregulated markets. The Board requests that interested participants to this proceeding discuss appropriate reporting or market monitoring requirements for the Board's consideration.

For example, the Board could require that providers of deregulated services or facilities in specific markets provide the Board with after-the-fact informational tariff filings showing any and all price changes they choose to implement. Thus, in a deregulated market, the Board could require that each provider make an informational tariff filing within a certain number of days after each price change is implemented or each new service is offered. This would allow the Board (and the public) to evaluate the degree of price competition in the deregulated markets and to compare the resulting prices to the rates available in markets that continue to be regulated without imposing an undue burden or regulatory delay. If the informational filings show that prices in a deregulated market are substantially increased relative to regulated rates, that may be a sign of duopoly price-following. If instead the price in the deregulated market fall far below regulated rates, and below any reasonable estimate of the cost to provide service, that may be an indication of predatory pricing by one of the providers. In either case, the Board could use the informational tariff filings as a basis for initiating an investigation or, if necessary, taking immediate action.

This is only one possible form of market monitoring that the Board could implement as a part of deregulation in markets that do not meet the classic economic

tests for determining the existence of effective competition. The Board invites comment on this proposal and on other market monitoring systems the Board could consider.

THE STATUS OF COMPETITION FOR RESIDENTIAL SECOND LINES

Recent studies and publications indicate that a new trend is developing in the telecommunications market where residential second lines may be most at risk for substitution to wireless services.¹⁴ These sources indicate that many customers may view a wireless phone as an alternate communication method to a second wireline in the house.

For residential customers, the competition between wireless and wireline service for second lines may be notable. Based on number resource utilization forecast reports from the North American Numbering Plan Administrators, there are approximately 1.4 million wireless customers in Iowa compared to 3.1 million wireline customers. The Board believes there is substantial overlap in these figures given the total Iowa population. Residential customers who already have a wireless telephone may be less likely to purchase a second wireline when they are already paying for wireless service that can serve a similar function.

¹⁴ *Fixed-Mobile "Intermodal" Competition in Telecommunications: Fact or Fiction?* Phoenix Center Policy Bulletin No. 10, March 31, 2004, p. 7. See also *Flashback/Forward: Is Wireline Becoming Obsolete?*, Harper, Tom, The Messaging Industry Ass'n, www.commweb.com; *Cutting Cord May Not Cut Costs*, Greenspan, Robyn, Jupitermedia Corp., www.clickz.com; *Consumer Tips For Cutting the Cord; Switching to Wireless as Your Primary Phone Service*, Telecommunications Research Action Center, <http://trac.org>.

This rationale has been publicized throughout the industry at least since the late 1990's. For example, in a speech on May 30, 1997, Joseph Farrell, chief economist at the FCC, indicated that deregulation of the provision of second residential lines was a possibility deserving of serious consideration.¹⁵ Mr. Farrell noted that for some users, especially those who intend to use a second line for "overflow" conversations, wireless service would be an acceptable, and in some ways better, substitute for a second wireline.¹⁶ The Board believes that Mr. Farrell's comments may have been made for the purpose of stimulating discussion of these issues at a time when the possibility of deregulation for residential second lines was not yet ripe. However, the Board proposes that this issue is ready for serious consideration at this time.

More recently, Michael Dunne, a spokesman for Qwest stated in an interview that Qwest had lost 162,000 lines in Oregon in the fourth quarter of 2002.¹⁷ Mr. Dunne further stated that the loss was mostly for second lines, not primary lines, and that the majority of the loss was due to teenagers who now opt for a wireless plan in place of a second line.¹⁸

Copies of each of these reports will be available for public review in the Board's Records Center as a part of the record in this docket.

¹⁵ *Prospects for Deregulation in Telecommunications*, Joseph Farrell. May 30, 1997, p. 16. www.fcc.gov/Bureaus/OPP/Speeches.html.

¹⁶ *Id.*

¹⁷ *Phone Companies Lose Land Lines to Wireless Users*, Jeff Melsner. The Business Journal, April 21, 2003, <http://twincities.bizjournals.com/portland>.

¹⁸ *Id.*

It appears this trend of wireless services as a viable substitute for residential second lines is worth investigating in this proceeding. Therefore, the Board proposes to consider deregulating residential second lines throughout Iowa.

At this time, the Board does not propose to consider deregulation of second (or other secondary) lines serving business customers. The Board understands that many such lines are used for data transmission rather than voice service. This may include facsimile transmission, credit card readers, and other similar devices. Currently, wireless service appears to be a poor substitute for these uses, making any possible deregulation of secondary lines for business customers premature.

The Board is aware that many residential customers also use secondary lines for data transmission, especially for dial-up access to Internet service providers (ISPs). Again, wireless service appears to be a poor substitute for wireline service insofar as ISP (and similar data) calls are concerned. If, however, the majority of the residential secondary line market is primarily concerned with voice traffic, then it appears wireless service may still be an effective price restraint on wireline secondary lines, regardless of the primary use of any particular second line. In order to fully consider this situation, the Board specifically requests comments concerning the current uses of residential secondary lines, the market share relationships between and among their uses, and the total price comparison between residential secondary lines and wireless service packages that can serve similar purposes.

PRICE PLAN ACCOUNTING ISSUES

Iowa Code § 476.1D(2) and 199 IAC 5.7 require that when a service or facility is found to be subject to effective competition, deregulation is not usually complete until the carrier files, and the Board approves, a deregulation accounting plan. In recent dockets, the Board has not required detailed accounting plans because the affected carriers are operating under price regulation plans and the accounting plans would serve no purpose. Here, however, the Board is proposing a more significant form of deregulation. The Board recognizes the possibility that in the event some services are deregulated within communities where providers are currently under price plan regulation, accounting issues may need to be addressed. As such, the Board requests comments including, but not limited to, whether the incumbents' accounting records are detailed enough to identify all investment, revenues, and expenses associated with local exchange service in a limited geographic area or a state wide residential service such as residential second lines.

INITIATION OF FORMAL PROCEEDING

Pursuant to 199 IAC 5.3(1), the Board will initiate a formal notice and comment proceeding, identified as Docket No. INU-04-1, proposing to consider whether the following services are subject to effective competition and should be deregulated:

1. Residential and business local exchange services in the Council Bluffs market, as defined above (see FN 10);

2. Business local exchange services in the Sioux City market, as defined above (see FN 11);

3. All local services in overbuilt communities where competitors have acquired a market share of greater than 50 percent of both residential and business customers, specifically the exchanges of Laurens, Mapleton, Spencer, Storm Lake, Whiting, Armstrong, Belle Plaine, Conrad, Coon Rapids, Delmar, Forest City, Harlan, Lowden, Oxford, Oxford Junction, Primghar, Saint Ansgar, Solon, Stacyville, Stanwood, Steamboat Rock, and Tiffin as defined in the relevant ILEC tariffs; and,

4. Residential secondary lines throughout Iowa.

The Board will also consider whether a market-monitoring mechanism should be required in the event of deregulation to ensure the continued existence of effective competition.

The Board intends to develop a complete evidentiary record concerning the application of the criteria in subrule 5.6(1), along with the additional criteria discussed in this order, to the identified services. Participants in this docket will be permitted to file sworn statements of position and counterstatements, pursuant to 199 IAC 5.4. An oral presentation, at which all participants will be permitted to cross-examine other participants, will be held pursuant to 199 IAC 5.3(4) and 5.5.

COMMENTS

The Board specifically requests comments on the following issues:

1. The Board's use of the telecommunications competition survey report as a basis for deregulation;
2. The proposed deregulation of business and residential local exchange service in the Council Bluffs market, as discussed in this order;
3. The proposed deregulation of business service in the Sioux City market, as discussed in this order;
4. The proposed deregulation of all local exchange service in the overbuilt exchanges, as discussed and identified in this order; and,
5. The use of a market-monitoring mechanism to ensure the continued existence of effective competition.

The Board intends that this proceeding should be focused on the issues designated above. Nevertheless, in anticipation of the second phase of the Board's intended deregulation process, the Board also seeks comment regarding the effectiveness of competition from CLECs that rely on UNE-P and UNE-loop to provide local telephone service, both now and in the future.

NOTICE

The Board's rules require that upon docketing a petition for deregulation of a telecommunications service or facility, the Board will cause notice of the proceeding to be published in the Iowa Administrative Bulletin and the Board may require specific notice to persons identified as competitors. 199 IAC 5.3(3). The Board will direct the

Executive Secretary to serve a copy of this order on each telecommunications carrier with a tariff on file with the Board.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. A formal notice and comment proceeding, identified as Docket No. INU-04-1, is initiated proposing to consider deregulation of the services described in this order, pursuant to Iowa Code § 476.1D (2003) and 199 IAC chapter 5.
2. The Executive Secretary of the Board is directed to cause notice of these proceedings to be published in the Iowa Administrative Bulletin, in the form attached to this order. In addition, a copy of this order shall be mailed to each telecommunications carrier with a tariff on file with the Board.
3. The following procedural schedule is established:
 - a. Any interested person may file, on or before June 14, 2004, a statement of position concerning any of the issues specifically addressed in this order. Statements of position must substantially comply with 199 IAC 2.2(2). Ten copies must be filed with the original.
 - b. Any person filing a statement of position may file a counterstatement replying to the comments of other participants no later than July 19, 2004. The original and ten copies must be filed with the Board and copies must be served upon all participants. Counterstatements must substantially comply with 199 IAC 2.2(3).

c. All statements and counterstatements shall be sworn and shall be directed to the Executive Secretary, Iowa Utilities Board, 350 Maple Street, Des Moines, Iowa 50319-0069.

d. An oral presentation is scheduled for the purpose of taking sworn testimony concerning the statements and counterstatements. The oral presentation shall be held August 24, 2004, beginning at 10 a.m. in the Board's hearing room at 350 Maple Street, Des Moines, Iowa. All persons filing written statements shall have at least one witness available at the oral presentation who may be cross-examined on the subject matter of the written statement. Cross-examination may be by the Board, Consumer Advocate, and other participants, as the Board may deem appropriate to develop the record fully. Persons with disabilities requiring assistive services or devices to observe or participate should contact the Board at 515-281-5256 in advance of the scheduled date to request that appropriate arrangements be made.

4. All ILECs and CLECs providing service in the Council Bluffs and Sioux City markets, as defined in this order, as well as the ILECs and CLECs providing service in the following overbuilt exchanges: Laurens, Mapleton, Spencer, Storm Lake, Whiting, Armstrong, Belle Plaine, Conrad, Coon Rapids, Delmar, Forest City, Harlan, Lowden, Oxford, Oxford Junction, Primghar, Saint Ansgar, Solon, Stacyville, Stanwood, Steamboat Rock, and Tiffin, shall file updated survey responses for those exchanges. The updated responses shall be filed on or before June 14, 2004, and

shall include data as of May 1, 2004. A copy of the survey form is attached to this order as Attachment A. If assembling data as of May 1, 2004, is likely to present an undue burden for an ILEC or CLEC, the company may file a request for authorization to use other data. The request, which must be filed on or before May 21, 2004, shall specify the reason that May 1, 2004, data would be unduly burdensome and shall identify the data that is available and proposed for use.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 7th day of May, 2004.

Iowa Utilities Board
INU-04-1 Telecommunications Competition Survey for Retail Local Voice Services

Competition Survey Instructions and Guidelines

This survey only addresses retail local voice services being provided to consumers within the state of Iowa. This survey instrument is divided into three sections. Part I of this survey requests a physical count on the number of customer connections for which a service provider is billing consumers for retail local voice service. Part Two requests information on the recurring monthly pricing of the retail local voice services offered to consumers. Part III asks for information on how your organization advertises the availability of services to consumers. All requested information is as of **May 1, 2004**. Listed below are a few definitions taken in part from the Iowa Administrative Code (IAC) that should help in defining the scope of this survey.

“Local service” means telephone service furnished between customers or users located within an exchange or service area. (Follows IAC 199-22.1(3))

“Exchange area” or “Service area” means the general area in which the telephone utility holds itself out to furnish local telephone service. (Follows IAC 199-22.1(3))

For the purpose of this survey, Retail Local Voice Service Connections or the functional equivalent are facilities that provide voice grade access to the public switched network that includes local usage, dual tone multifrequency signaling or its functional equivalent, access to emergency services, access to operator services, access to interexchange services, and access to directory assistance. Toll limitation for qualifying low-income consumers is not included in this list of functionalities since carriers requesting federal “Eligible Telecommunications Carrier (ETC)” status have been granted a waiver of this provision. This definition follows Iowa Administrative Code 199-39.2(1).

PART I: Customer Connections

The purpose of this portion of the survey is to obtain actual counts of the number of retail local voice service connections being furnished by each carrier to end users or customers in the various communities of Iowa. Many different types of

facilities and technologies are used within the state to provide retail local voice services. Count customer connections based on how customers are billed rather than how services are provisioned. For the purpose of this survey, retail local voice services or the functional customer connection equivalents must be capable of providing service functionalities as defined in the previous paragraph and must be producing billed revenues for the service provider.

Column ----- Column Description ----- Explanation

- (a) Community Name – Community Name
- (b) Exchange Name or Service Area – General area or location where telephone service utility holds itself out to furnish retail local voice service.
- (c) Service Provider Type – Incumbent or Competitor
- (d) How the Service is Provisioned:
 - F = Facility Based owned by the provider
 - U = Service provided using leased or purchased UNEs
 - R = Service provided through the use of resale facilities.
 - C = Service provided by using a combination of owned facilities and purchased UNEs
- (e) NPA-NXX – Each Number Plan Area-NXX as assigned to your organization by NANPA.
- (f) Number of Retail Local Service Connections or Functional Equivalent for each NPA-NXX – Numerical count of the quantity of retail local voice connections provided to end users. Please provide counts, if possible, based on the service being provided as being residential (RES) or business (BUS). If offered services are not distinguished as either residential or business, enter the counts in the combination (COMB) column.

PART II: Pricing Information

The purpose of this portion of the survey is to obtain pricing information on Retail Local Voice Service. Local service providers often provide numerous calling plans for consumers in specific areas and local service plans vary by service provider. Please list all the local service plans offered in each of the exchanges or service areas where service is provided. Local service plans or packages may also include other services, such as regional toll calling, custom calling features, or extended area calling service.

Column ----- Column Description ----- Explanation

- (g) Exchange Name or Service Area – Same as column (b).
- (h) NPA-NXX – Same as Column (e).
- (i) Type of service or service plan – Common name of the service or plan as sold by the service provider.
- (j) Monthly Rate – Recurring monthly dollar amount for the service being provided.
- (k) Recurring Monthly End User Charges – Charges added to the consumer billing as part of the charges for receiving service.
- (l) Other Monthly Recurring Charges – Charges that are added to the end users bill that are not usually considered to be part of the rates for recovering the costs associated with the service. These charges could include assessments for 911/E911, property tax surcharges, number portability charges or local fees, taxes, and surcharges. Do Not Include Federal Universal Service Charges, state, or federal taxes. Please identify each charge.
- (m) Service or Service Plan Details – Briefly describe the service and the components of each plan. Explanations could include: residential single line service, business multiline service, includes custom calling features, regional calls included, 500-minute plan with 120 minutes of 7:00 AM to 7:00 PM usage, etc.

PART III: Advertising / Marketing

This section of the survey is structured to gather information on how service providers advertise or market their retail local services. If your organization has advertised in Iowa in the past twelve months (May '03 through April '04) please respond to the questions in this section and provide copies of written or printable advertisements.

Should you have questions concerning this survey or desire to have an electronic copy, contact Larry Stevens at (515) 281-4725 or at larry.stevens@iub.state.ia.us. Completed survey forms can be returned by US mail to Larry Stevens, Iowa Utilities Board, 350 Maple Street, Des Moines, Iowa 50319. Electronic replies should be returned to larry.stevens@iub.state.ia.us.

Iowa Utilities Board
INU-04-1 Telecommunications Competition Survey for Retail Local Voice Services
As of May 1, 2004

Company Name _____ Address _____

Contact Person _____ Telephone number _____ Fax # _____

E-Mail Address _____

1.) Does your company currently provide local telecommunications retail voice service in the State of Iowa?

Yes ☐ No ☐

2.) If yes, what type of Service provider:

ILEC ☐ CLEC ☐ Cable ☐ Wireless ☐ Other ☐ Explain: _____

3.) Please use the worksheet formats in the following three pages to provide information on the communities and locations in Iowa where you provide retail local voice services. Create additional pages as needed to complete this survey.

PART I - Customer Connections

Community Name (a)	Exchange Name or Service Area (b)	Service Provider Type: I=Incumbent C=Competitor (c)	How the Service is Provisioned: F = Facilities Based U = UNEs R = Resale C = Combination (d)	NPA-NXX (e)	Number of Local Voice Service Connections or Functional Equivalents for Each NPA-NXX (f)		
					RES	BUS	COMB

PART I - CONTINUED

[illegible]

Iowa Utilities Board

INU-04-1 Telecommunications Competition Survey for Retail Local Voice Services

As of May 1, 2004

PART II – Service Rates

Company Name _____

[illegible]

Iowa Utilities Board
INU-04-1 Telecommunications Competition Survey for Retail Local Voice Services
As of May 1, 2004

PART III – Advertising / Marketing

Company Name _____

1. During the past 12 months (May '03 – April '04) has your organization advertised the availability of retail local service, by itself or included as a service in a package offering, to any consumers in the State of Iowa?

Yes ☐

No ☐

2. In how many months of the last 12 did your organization advertise? _____ (answer: 0-12)

3. If you answered yes to question #1, how has your organization advertised (mark all that apply):

_____ Newspaper

_____ Radio

_____ Telemarketing

_____ Television

_____ Billing Insert

_____ Internet (other than web site)

_____ Direct Mailing

Other, Please list each:

4. If the advertisement has been in a written or printable format, please attach a photocopy of each advertisement to the completed survey. If the survey is being completed in an electronic format, advertisements can be scanned and returned as electronic files.

UTILITIES DIVISION [199]

NOTICE OF INTENDED ACTION

The Utilities Board (Board) hereby gives notice that on May 7, 2004, the Board issued an order in Docket No. INU-04-1, In Re: Deregulation of Local Exchange Services in Competitive Markets, "Order Initiating Formal Notice And Comment Proceeding," pursuant to Iowa Code § 476.1D, to consider whether local exchange service to business and residential customers in certain Iowa communities is subject to effective competition and should be deregulated. The Board will also consider in this proceeding whether residential second line service throughout Iowa is subject to effective competition and should be deregulated.

Copies of the Board's complete order initiating formal notice and comment proceeding may be obtained from the Board by calling 515-281-6240 or off the Board's web page, <http://www.state.ia.us/iub>.

Any interested person may file, on or before June 14, 2004, a statement of position concerning the possible deregulation of local exchange service to business customers in the Sioux City market and business, residential customers in the Council Bluffs market, and business and residential customers in a number of smaller exchanges as described in the Board's order, as well as the possible deregulation of residential second line service throughout Iowa. Comments regarding other issues raised in the Board's order must also be filed on or before

June 14, 2004. Statements of position must substantially comply with 199 IAC 2.2(2). Ten copies must be filed with the original. All written statements should clearly state the author's name and address and should make specific reference to Docket No. INU-04-1.

Any person filing a statement of position may file a counterstatement replying to the comments of other participants no later than July 19, 2004. Ten copies must be filed with the original and copies must be served upon all participants filing statements to which the counterstatement responds. Counterstatements must substantially comply with 199 IAC 2.2(3).

All statements and counterstatements shall be sworn and directed to the Executive Secretary, Iowa Utilities Board, 350 Maple Street, Des Moines, Iowa 50319-0069.

An oral presentation is scheduled, pursuant to 199 IAC 5.3(4) and 5.5, for the purpose of taking sworn testimony concerning the statements and counterstatements. The oral presentation shall be held August 24, 2004, beginning at 10 a.m. in the Board's hearing room at 350 Maple Street, Des Moines, Iowa. All persons filing written statements shall have at least one witness available at the oral presentation who may be cross-examined on the subject matter of the written statement. Cross-examination may be by the Board, Consumer Advocate Division of the Department of Justice, and other participants, as the Board may deem appropriate to develop the record fully. Persons with disabilities requiring assistive services or devices to observe or

participate should contact the Board at 515-281-5256 in advance of the scheduled date to request that appropriate arrangements be made.

May 7, 2004

/s/ Diane Munns

Diane Munns
Chairperson